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SIPDIS

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SUBJECT: SOUTH AFRICA: BARCLAYS TO BUY ABSA

1. (U) Summary. President Mbeki has publicly given his support for Barclays Bank's planned bid to purchase a 50.1% stake in ABSA, the fourth largest bank in South Africa. While Finance Minister Trevor Manuel has the final say, Mbeki's support certainly paves the road for approval. The acquisition represents a clear departure from previous government policy to keep the four large banks South African owned. Industry insiders believe that Barclays' takeover of ABSA will be positive for South Africa, but are not sure that it will lead to more competition and thus lower banking fees as the government and consumers would like. Some local labor and political organizations have voiced reservations about potential job cuts and capital leaving the country, but neither of these events is likely to happen in this case. End Summary.

#### Barclays' Interest in ABSA Goes Public

2. (U) On September 23, Barclays confirmed its intention to purchase a 50.1% stake in ABSA, the fourth largest bank in South Africa, for R20 billion (approximately \$3.1 billion). ABSA's board has reportedly accepted Barclays' bid in principle, but a final offer will not be made until South African Reserve Bank (SARB) regulators approve Barclays' bid, and Barclays can complete due diligence on ABSA. Due diligence will determine Barclays final offer price and percentage stake. It will then be up to ABSA shareholders to accept Barclays' offer, Barclays' shareholders to approve the deal, and South African Finance Minister Manuel to give a green light.

3. (U) Several weeks before Barclays emerged as ABSA's suitor, as Barclays talked to Sanlam about its 21.3% shareholding in ABSA, rumors abounded about a foreign takeover of a local bank. On September 23, Barclays and ABSA came clean with the announcement that, indeed, they were talking to each other. Sanlam, a South African financial services company, is ABSA's leading shareholder. Sanlam also relies on ABSA retail outlets to market its insurance products, a practice it would want to continue after Barclays takes over.

4. (U) U.S. financial advisors are involved in the acquisition. JP Morgan is advising Barclays, while Merrill Lynch and Goldman Sachs are advising ABSA. The acquisition of ABSA would be the largest investment outside of the United Kingdom for Barclays, and the largest single foreign investment in South Africa since 1994.

#### No Rivals

5. (SBU) The press has suggested that Standard Chartered (U.K.) or Hong Kong Shanghai Bank Corporation (HSBC) (U.K.) might be rival bidders for ABSA, or might be interested in a different South African bank -- but neither has publicly indicated any such interest. In fact, Standard Chartered flatly stated that it did not plan to place a competing bid on ABSA. Industry insiders that we contacted see no indication that either Standard Chartered or HSBC are serious about a South African acquisition at this time.

#### The Road is Paved for Barclays

6. (U) The road is paved for approval of Barclays' bid. Before going public, top executives from Barclays met with President Mbeki to ask for his blessing. They assured him that Barclays would live up to ABSA's black economic empowerment commitments under the Financial Sector Charter, and that Barclays was coming to South Africa for the long haul. Satisfied with Barclays' good intentions, Mbeki immediately trumpeted Barclays' move on ABSA as an indication of strong foreign investor confidence in South Africa, and as vindication that his macroeconomic stabilization and social transformation policies were working. Publicly, Finance Minister Manuel and SARB Governor Tito Mboweni have had nothing negative to say about the deal, leading to the widely held presumption that nothing is standing in the way.

#### What is Happening to the Four-Pillar Policy?

17. (U) Consolidation of the South African banking industry during the past decade culminated in what is known as the government's "four-pillar" policy, i.e., the government's preference for keeping a minimum of four large banks relatively competitive, healthy, and South African owned. The big four are Standard Bank, FirstRand, Nedcor, and ABSA. SARB Governor Mboweni recently reiterated the government's "preference for the big four South African banks to remain in South African hands," but had to admit that "nothing remains stable." He confessed that the Treasury and the SARB would have to consider modifying the policy at some point. Some would argue that the policy lost its luster after Nedcor's majority shareholder, Old Mutual, moved its primary stock listing and headquarters to London from South Africa. Old Mutual is an international financial services group with strong South African roots (where it still derives most of its income) that has maintained a secondary listing for itself on the JSE Securities Exchange and a primary listing for Nedcor. If there was any doubt before as to whether the four-pillar policy was standing, Barclays' takeover of ABSA should clear it up. The policy will have to change.

18. (SBU) The question is, "How much?" Given that two of the four major retail banks in South Africa are foreign owned, will the government close the door to future foreign takeovers, or leave the door open? Industry insiders do not think that the government will allow another foreign takeover of a big bank after ABSA, but this may depend on how and why Manuel chooses to approve the Barclays deal. We will be watching to see whether he leaves the door open for other foreign banks to compete in South Africa, and to bring more capital to the country.

#### Some Reservations, but Industry is Supportive

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19. (U) Media reports suggested that Barclays would have an unfair competitive advantage in South Africa if no other foreign banks were allowed in, but most banking industry officials do not seem to be worried. Indeed, stock prices in all banks got a shot in the arm on news of Barclays' bid. Many in the private sector are hopeful that increased competition among the big four will bring down the high cost of local banking and make the whole economy a bit more competitive. Currently, South African banks derive about half their income from banking fees, far more than in more developed markets. The acquisition is also seen as good for South Africa, as it encourages more foreign investment.

110. (SBU) A U.S. bank executive held reservations about whether it was a good idea for Barclays to leak news of the deal so soon. ABSA shares have been increasing in value ever since and this only made the deal more expensive. The executive also questioned the logic of buying a South African bank at a time when the rand was overvalued. The rand has appreciated 16% against the British pound and 25% against the U.S. dollar since January 2003. However, this may not be the issue it appears to be. SARB Governor Mboweni recently suggested that Barclays might not need many British pounds to purchase ABSA. He pointed out that the actual foreign exchange inflow "might be disappointing" because Barclays could finance much of the purchase through rand holdings that it has accumulated over time. This would take pressure off the SARB to "mop up" excess foreign exchange in an effort to keep the rand from appreciating further.

#### What Will Happen to ABSA and its Employees?

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111. (U) Some local labor and political organizations voiced reservations about job cuts after mergers and the potential of capital leaving the country, but neither of these events is likely to happen in the case of ABSA. ABSA's CEO, Steve Booysen, stated publicly that the deal was "about growth and leadership, not retrenchment" or capital leaving the country. He pointed out that there was little overlap between ABSA's and Barclays' Africa business )- with the only overlap in the areas of corporate and investment banking in South Africa, Tanzania, and Zimbabwe. A Banking Council official echoed this sentiment, noting that the acquisition was more a transfer of ownership than a merger. Moreover, Barclays has a small number of employees in South Africa, making the likely solution to any redundancies the shifting of employees to other areas.

112. (U) In 1986, Barclays disinvested from South Africa, leaving behind what later became First National Bank, now owned by FirstRand Limited. Barclays returned in 1995 as a much smaller entity, focusing on corporate and investment banking, and on wealth management. Barclays now has 400 employees in South Africa, compared to 6,900 in all of Africa. At this time, no one knows whether Barclays will retain the ABSA brand in South Africa, where it is well known on the retail level. ABSA, with Afrikaner roots, is the largest retail bank in South Africa, employing 32,000. Barclays is well known internationally and is locally strong

in corporate banking and credit cards.

Comment

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113. (SBU) It is difficult for South Africans to argue against Barclays' acquisition of ABSA, as it has Mbeki's blessing and represents a very large, high profile foreign investment for the country -- increasingly important to a government that wants to grow the economy and reduce high unemployment. Whether it brings more competition to the banking sector and along with it lower banking fees is another question. The private sector would like to see that happen, but is not convinced that Barclays will not simply join the clubby profitability of the big four. For its part, the government would like to see banking services more affordable, both for economic competitiveness reasons and to make services more accessible to the large "unbanked" population in South Africa. Other unanswered questions concerning the acquisition revolve around what Barclays will do with the ABSA brand, and how the government might modify its four-pillar policy. Will Barclays' purchase of ABSA open or close the door for future foreign acquisitions of South African banks?

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